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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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March 10, 1993

Ms. Donna Searcy
Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, DC 20554

Re: CC Docket No. 92-296, Simplification of the Depreciation Prescription Process

Dear Ms. Searcy:

Enclosed herewith for filing are the original and four (4) copies of MCI Telecommunications Corporation's Comments in the above-captioned proceeding.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Petition furnished for such purpose and remit same to the bearer.

Sincerely yours,

Elizabeth Dickerson

Elizabeth Dickerson
Manager, Regulatory Analysis

Enclosure
ED/ms

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20054

In the Matter of	)	
	)	
Simplification of the Depreciation Prescription Process	)	CC Docket No. 92-296
	)	
	)	
	)	

COMMENTS

MCI Telecommunications Corporation ("MCI") hereby submits its comments in response to the Notice of Proposed Rulemaking ("NPRM") filed by the Commission on December 29, 1992, in the above-captioned proceeding. The Commission is proposing four optional methods of simplifying the prescription process the local exchange carriers ("LECs") follow for determining their depreciation expenses. Specifically, it advances the Basic Factor Range Option ("Option 1"), the Range of Rates Option ("Option 2"), the Depreciation Schedule Option ("Option 3"), and the Price Cap Carrier Option ("Option 4"). Each option entails varying degrees of Commission oversight, reliance on historical formula, cost support requirements, cost savings, and LEC flexibility.

In general, MCI believes the current depreciation prescription mechanism should be retained until the Commission addresses the fundamental issue of who should fund the plant whose obsolescence is accelerated by the increasing desire of the LECs to enter competitive markets. Also, the Commission should quantify the impact of the proposed changes on the LECs' costs and assess the four options in relation to other Commission policy. If the Commission nevertheless proceeds with its simplification efforts, it should select Option 1 (which retains the greatest degree of oversight and most prevents possible abuse of the depreciation process by the LECs to serve their competitive ends), but not until it has recalculated the price cap productivity factors to reflect the increased LEC flexibility.

I. **The Generic Issue of Depreciation Prescription Methodologies Cannot be Considered in a Vacuum Because it is Integral to Other Issues and Dockets.**

The issue of who should bear the cost of the accelerated depreciation of certain categories of plant that the LECs consider obsolete is conspicuously absent from the instant proceeding. MCI acknowledges that it utilizes the public switched network and is certainly willing to fund appropriate LEC network deployment through that portion of access charges that represents depreciation costs. The problem arises when LECs attempt to accelerate the depreciation of useful plant and establish mechanisms whereby the IXCs are required to pay increased depreciation expenses to fund LEC ventures into competitive markets. To the extent that existing or improved network facilities are necessary to meet the IXCs' access requirements, IXCs should bear their fair portion of those costs. To the extent that network obsolescence is driven by LEC entry into competitive markets, it is inappropriate to assign those costs to monopoly ratepayers.[1] Since it is the LEC shareholders who will benefit from anticipated competitive revenues available from certain new technologies, they should bear both the risks and the costs of funding the modernization program.

[1] It is important to note that MCI distinguishes, for example, between fiber facilities that provide DS3 services to the IXCs and fiber loop that is not necessary for the degree of access needed to originate and deliver interexchange traffic.

Any regulatory changes that are implemented "in light of market. . . changes" (NPRM, at para. 8) must accurately reflect the new market. LECs must not be granted the best of both worlds. That is, they should not be allowed to operate in competitive markets under the safety net provided by their regulated monopoly ratepayers. Unless the Commission resolves the issue of who should fund the accelerated depreciation of plant the LECs contend is obsolete yet is still useful monopoly ratepayers, this docket cannot be fairly resolved. The LECs will focus their efforts more on obtaining a depreciation calculation mechanism that helps them achieve network modernization for competitive services, rather than on the Commission's goal of achieving simplification in order to reduce administrative costs.

Any depreciation simplification decisions reached in the instant proceeding likely will have a profound effect on CC Docket No. 92-213 in which the Commission is striving to develop a cost-based long-term local transport structure. In that docket, many of the LECs are requesting the freedom to amortize their "under-depreciated copper equipment" in order to reduce the residual interconnection charge. For example U S West observed:

> [T]here was a significant depreciation reserve deficiency associated with copper cable and circuit equipment and that this equipment accounted for approximately 65% of U S WEST's local transport investment. U S WEST urged the Commission to allow LECs to amortize this reserve deficiency over a four-year period.[2]

[2] In the Matter of Transport Rate Structure and Pricing, CC Docket No. 91-213, U S West Comments, filed February 1, 1993, at pp. 19-20.

U S West and other LECs are asking for the same exogenous treatment of this reserve deficiency that the Commission accorded other reserve deficiencies and the inside wire amortizations. The Commission must recognize the interrelation of this and other key regulatory issues and not circumvent these matters by resolving the simple mechanics of depreciation prescription in an isolated docket.

II. The Commission Should Quantify the LEC Administrative Cost Savings Anticipated Under its Proposals as Well as the Impact They Could Have on LEC Earnings.

The Commission notes that certain "market and regulatory changes and alleged high costs of depreciation analysis" raise the issue of whether the current LEC depreciation calculation process is necessary. (NPRM, at para. 4; emphasis added) LEC estimates of the cost of calculating depreciation rates are from $35 to $50 million (id.), though they do not indicate what percentage of those costs would be eliminated by streamlining the regulatory process.

Calculating and accounting for the depreciation of any business entity's assets is part of the cost of doing business, and MCI believes that the LECs have failed to demonstrate that the costs they incur are greater than those of any non-regulated business. Nor have they shown either that modification of the depreciation prescription procedure would result in a significant costs savings, or, more importantly, that the degree of the cost savings is profound enough to justify the commensurate loss in Commission oversight that adoption of any of these options will yield.

In fact, any claims by the LECs that cost savings will be significant must be viewed with acute skepticism. Even if the higher $50 million estimate in administrative costs were eliminated altogether, it would amount to only .3676% of the total BOC and GTE 1991 operating expenses of $1.6 billion. (1991 ARMIS Report 43-01) This lack of materiality should alert the Commission to the true motive behind the LECs' interest in simplifying depreciation rate calculation, especially in light of the LECs' incessant clamoring for faster depreciation of certain categories of plant. This is particularly relevant when the plant the LECs contend is obsolete is that which can support basic interexchange access functions, but not all of the new competitive services or ventures contemplated by the BOCs.

MCI believes that the LECs desire modifications to depreciation prescription methods, not to achieve administrative savings -- which are minimal or nonexistent -- but to gain increased flexibility in order to accelerate the depreciation of their plant that cannot support competitive enterprises. The Commission should not adopt a simplified depreciation calculation method unless the LECs can show that the promised administrative savings are both tangible and significant. They should be required to estimate the anticipated savings associated with each of the Commission's proposals in order to establish there is merit in even contemplating the proposed options.

Even if the LECs can demonstrate significant savings -- which MCI doubts -- the Commission has not analyzed the impact its proposals will have on the LECs' monopoly ratepayers. If the administrative savings to the LECs is trivial and the IXCs are subjected to either increased rates or reduced sharing opportunities, the Commission should abandon its simplification efforts altogether. MCI submits that any relaxation of the depreciation methodology will serve only to shift more costs to the

IXCs in a non-cost-causative manner. That is, not only will the LECs' depreciation rates that have little connection to the remaining life of the network components that are necessary to provide access services, but the LECs will be able to pass on to the IXCs costs associated with network functionality the IXCs do not need.

Further, the increased flexibility that all the Commission's options offer LECs only serves to expand the occasions the LECs have to exploit depreciation expense levels to their financial benefit. LECs already have the opportunity to fashion the timing of network deployment or make other business decisions so that the resulting depreciation levels or increased expenses can achieve their earnings goals.[3] If the Commission further relinquishes control over the depreciation process and monitors the results on a less detailed level, the LECs will be able to extend their manipulation as well to both the underlying data and/or the formula that the Commission currently scrutinizes. The Commission should reject any new prescription methodology that

[3]The NYNEX companies provided an example of the type of timing game that LECs can play if the Commission simplifies its depreciation calculation mechanism. As MCI noted in its Petition to Reject or, in the Alternative, Suspend and Investigate ("Petition"), filed on April 29, 1992, in response to the LECs' 1992 Annual Access Charge Tariff Filings, NYNEX used a one-time charge to earnings to cover the costs of workforce downsizing to gain an increase in its price cap indices. (Petition, pp. 7-10.) Similarly, the price cap LECs increased their aggregate operating expenses in the fourth quarter that year by nearly $425 million, while over the same period revenues increased by only $40 million. By causing the cumulative net return of price cap LECs to plummet by $223 million, the industry effectively retained earnings that it might have had to share had it not "manipulat[ed] the interplay between the sharing mechanism and earning[s] results." (Id., p. 11.) The unnecessary flexibility that price caps already affords LECs opportunities to game the process will be exacerbated if can be maximized if the Commission adopts depreciation mechanisms that allow non-cost based variations in depreciation expenses.

exchanges accuracy for simplification because of the potential impact such changes can have on the IXCs.

Nor will retaining endogenous treatment for depreciation rate changes insulate the IXCs from the increased costs of the Commission's proposals. The Commission itself recognizes that "because price cap carriers would generally not be able to pass along depreciation expense changes, higher depreciation expense can lead to lower earnings for those carriers." (NPRM, at para 8, note 8.) Endogenous cost changes, then, can have a significant impact on either end of the LECs' earning ranges. That is, a LEC that is approaching the earnings level at which point sharing commences can use the flexibility the Commission's four options offer to forestall the activation of the sharing process. Similar action would be available for a LEC who is at risk of under-earning its target and whose only hope of financial improvement is to trigger the lower adjustment formula mechanism. Manipulation of depreciation costs by a LEC at that point could provide a much-needed, but otherwise unavailable, price increase.

MCI has analyzed BOC and GTE 1991 ARMIS Report 43-01 data to illustrate the impact that untethered depreciation practice can have on monopoly services users. The results of this analysis, included as an attachment to these comments, show that a 1% increase in a LEC's depreciation expenses will result in a 1.3% decrease in its earned rate-of-return. This means that there is a greater than one-to-one relationship between a change in expenses and the effect on earnings -- even when exogenous treatment is denied. Because the level of the LECs' earnings affects their prices and their sharing obligations, the Commission should calculate the change in depreciation expenses that each of its options could produce. The anticipated costs savings to the LECs must be balanced against the increased costs to the IXCs in order to determine the effect that simplification of depreciation prescription could have on the industry overall.

III. <u>If the FCC Nonetheless Streamlines Depreciation Expense Calculations, Option 1 Is the Only Feasible Alternative</u>.

As noted, MCI is not convinced that the need for a "keen regulatory eye . . . to ensure 'reasonable charges' for ratepayers" (NPRM at para. 7.) has diminished to the extent that would justify the relaxation of the scrutiny of the LECs' depreciation process the Commission is proposing. If the Commission nonetheless proceeds with its effort to reduce "alleged high costs," MCI urges the Commission to adopt Option 1. Though it removes the detailed studies that underlie depreciation calculations, it is the closest to the existing methodology and affords the most regulatory scrutiny.

Option 2 fails to offer any of the safeguards that characterize Option 1. The Commission must retain some relationship between the factors that determine an asset's depreciable life and the depreciation expense level carriers may select. This is because LECs have an undisputed incentive to select the shortest lives available for most network investment. Also, any methodology that is adopted must restrict the percentage change of depreciation expense between periods, as Option 1 affords. Without such a precaution, the LECs would likely transition as quickly as possible to the fastest depreciation rate, despite the true remaining life of the asset.

Because, as the Commission acknowledges, Option 3 provides the greatest deviation from accuracy in matching allocation of costs with plant consumption

(NPRM, at para. 33.), it should also be rejected. On its face, Option 3 fails achieve the "ultimate purpose of continually estimating depreciation rates"; that is, to "most accurately allocate plant costs to expense at a rate representative of the actual consumption of the plant." (NPRM, at para. 5) Use of average depreciation schedules fails to recognize the true useful lives of plant, and Option 3 should not be implemented.

Finally, the Commission should reject Option 4 because it provides virtually no regulation at all. Third party comments would be meaningless because there would be no supporting data submissions on which affected parties could base their review of proposed rates. Under this proposal, depreciation expense calculations would be reduced to a purely political level, with no regard for either the actual uses of or the actual lives of the assets.

IV. Any Modifications to Depreciation Calculation Methodology Should not Be Implemented During the Initial Four Year Price Cap Trial.

MCI urges the Commission to delay any modification to the depreciation process until the current four year price cap trial has ended. The potential increase in depreciation expenses was not contemplated when price cap rules were formulated, and the focus of instant NPRM is not broad enough to consider the impact of these changes on the price cap mechanism. Nor is the increased flexibility that the Commission anticipates its proposed options will provide the LECs in the calculation of the LECs' current productivity factors. Tying any increased depreciation calculation flexibility to an increase in the price cap productivity factors is critical to attempt to restrict the extent to which IXCs fund the increased depreciation expenses that will result from adoption of any of the Commission's simplification options.

V. Conclusion

In sum, it is premature to consider the issue of depreciation expense calculation in an isolated docket that circumvents the underlying issue of who should fund network investment that is made primarily, if not solely, to support competitive ventures. If the Commission nonetheless proceeds with its simplification process, MCI urges it to adopt Option 1, but only after it has confirmed the administrative cost savings for the LECs and calculated the financial impact this change will have on the IXCs.

Respectfully submitted,

MCI TELECOMMUNICATIONS CORPORATION

Elizabeth Dickerson

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March 10, 1993

MCI TELECOMMUNICATIONS CORPORATION
DEPRECIATION ANALYSIS

ATTACHMENT 1

LN NO.	DESCRIPTION	TOTAL RBOC/GTE	AMERITECH	BELL ATLANTIC	BELLSOUTH	NYNEX	PACIFIC	SOUTH-WESTERN	US WEST	GTE
L1	'91 DEPRE/AMORT	4,118,910	407,949	538,162	675,887	629,127	357,148	416,366	491,083	603,188
L2	'91 TOTAL PLANT	57,609,131	5,979,547	7,852,829	9,060,342	7,936,075	4,944,496	6,127,555	7,015,150	8,693,137
L3	EFFECTIVE DEP RATE (L3=L1/L2)	7.1%	6.8%	6.9%	7.5%	7.9%	7.2%	6.8%	7.0%	6.9%
L4	1% INCREASE IN DEP RATE (.01*L2)	576,091	59,795	78,528	90,603	79,361	49,445	61,276	70,152	86,931
L5	'91 AVG NET INVEST	30,028,503	2,976,968	4,040,150	4,647,879	4,220,962	2,462,890	3,189,287	3,642,396	4,847,971
L6	IMPACT ON ROR ((L4*(1-.34))/L5)	-1.3%	-1.3%	-1.3%	-1.3%	-1.2%	-1.3%	-1.3%	-1.3%	-1.2%

SOURCE: 1991 ARMIS 43-01 REPORTS

STATEMENT OF VERIFICATION

I have read the foregoing and, to the best of my knowledge, information, and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on March 10, 1993.

Elizabeth Dickerson

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CERTIFICATE OF SERVICE

I, Carolyn McTaw do hereby certify that copies of the foregoing MCI petition were sent via first class mail, postage paid, to the following on this 10th day of March 1993:

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